

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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STATEMENT OF  
HENRY ESCHWEGE, DIRECTOR  
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION  
BEFORE THE  
COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE  
OF THE  
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS  
ON THE  
COMMODITY FUTURES TRADING COMMISSION

WE WELCOME THE OPPORTUNITY TO BE HERE TO ASSIST THE SUBCOMMITTEE IN ITS OVERSIGHT OF THE COMMODITY FUTURES TRADING COMMISSION (CFTC). WE HAVE JUST COMPLETED A MAJOR REVIEW OF THE COMMODITY FUTURES TRADING COMMISSION. WE HAVE PROVIDED OUR DRAFT REPORT TO YOU. CONCURRENTLY, WE SUPPLIED THE REPORT TO THE COMMISSION FOR COMMENT. I WILL SUMMARIZE OUR PRINCIPAL FINDINGS AND PROPOSED ACTIONS IN AREAS OF CONCERN TO THE SUBCOMMITTEE.

OVERALL, WE NOTED NUMEROUS IMPROVEMENTS IN THE COMMISSION'S PERFORMANCE SINCE OUR 1978 REVIEW. HOWEVER, WE FOUND THAT EACH OF THE COMMISSION'S KEY REGULATORY PROGRAMS WE EXAMINED, INCLUDING REGISTRATION, SURVEILLANCE, AND RULE ENFORCEMENT REVIEWS, NEED TO WORK BETTER IF RAPIDLY EXPANDING TRADING ACTIVITY ON THE



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NATION'S COMMODITY FUTURES EXCHANGES IS TO OPERATE REASONABLY FREE FROM ABUSE. IT CONCERNS US THAT THE COMMISSION CONTINUES TO APPROVE EXPANSION OF TRADING BEFORE IT MORE FULLY DEVELOPS ITS MONITORING, EVALUATION, AND ENFORCEMENT PROGRAMS TO PROTECT THE INTEGRITY OF EXISTING TRADING.

MONITORING INDUSTRY SELF-  
REGULATORY ACTIVITIES

EXCHANGE SELF-REGULATION HOLDS PROMISE FOR FUTURE REDUCTIONS IN FEDERAL REGULATORY PROGRAMS. WE NEED TO KNOW FIRST, HOWEVER, THAT SELF-REGULATION WILL PROTECT THE PUBLIC INTEREST. CFTC'S RULE ENFORCEMENT REVIEW PROGRAM IS THE CENTERPIECE OF THE COMMISSION'S MONITORING OF ENFORCEMENT BY THE EXCHANGES OF THEIR OWN RULES. RULE REVIEWS HAVE IMPROVED marginally SINCE OUR 1978 REVIEW. SUBSTANTIAL IMPROVEMENTS ARE STILL REQUIRED, HOWEVER. THE REVIEWS TEND TO CONCERN THEMSELVES WITH WHETHER ESSENTIAL SELF-REGULATORY MACHINERY IS IN PLACE, RATHER THAN HOW WELL IT IS RUNNING. FOR EXAMPLE, A CFTC REVIEW OF THE NEW YORK MERCANTILE EXCHANGE CONDUCTED IN 1980 OVERLOOKED SERIOUS PROBLEMS BROUGHT TO LIGHT IN A SEPARATE 1980 CFTC ENFORCEMENT INVESTIGATION. REVIEWS, WHETHER THEY ARE COMPREHENSIVE OR FOCUSED, HAVE A LONG GESTATION PERIOD. THE COMMISSION HAS YET TO RECEIVE FROM ITS STAFF KEY REPORTS ON THE CHICAGO BOARD OF TRADE AND THE CHICAGO MERCANTILE EXCHANGE COVERING REVIEWS CONDUCTED IN 1979 AND 1980.

CFTC DOES NOT YET TIE ITS APPROVAL OF TRADING IN PROPOSED CONTRACTS AT A PARTICULAR EXCHANGE TO THE RESULTS OF RULE ENFORCEMENT REVIEWS CONDUCTED BY CFTC AT THAT EXCHANGE, AS AUTHORIZED IN THE

ACT. MAKING CONTRACT APPROVALS CONTINGENT ON ADEQUATE RULE ENFORCEMENT WOULD EFFECTIVELY PROMOTE MORE CONSCIENTIOUS ADHERENCE TO STATUTORY SELF-REGULATORY REQUIREMENTS.

WE EXPECT TO REPEAT A NUMBER OF RECOMMENDATIONS OFFERED IN 1978 TO IMPROVE RULE ENFORCEMENT REVIEWS, INCLUDING MORE SYSTEMATIC FOLLOW-UP, IMPROVED EVALUATION CRITERIA, AND A CONTINUATION OF COMPREHENSIVE REVIEWS UNTIL SELF-REGULATION IS WELL ENOUGH ESTABLISHED AT EACH EXCHANGE TO PERMIT REVIEW OF SELECTED ASPECTS OF EXCHANGE PERFORMANCE.

#### APPROVING NEW FUTURES CONTRACTS

THE PROCESS BY WHICH CFTC EVALUATES AN EXCHANGE'S APPLICATION TO TRADE STANDARDIZED FUTURES CONTRACTS IN A PARTICULAR COMMODITY STANDS AS ONE OF THE COMMISSION'S BEST TOOLS FOR MAINTAINING PROPERLY FUNCTIONING FUTURES MARKETS. OUR REVIEW OF TEN RECENT CONTRACT SUBMISSIONS SHOWED THAT CFTC HAS IMPROVED THIS REVIEW PROCESS SINCE 1978. FOR EXAMPLE, CFTC HAS SUCCEEDED IN GETTING EXCHANGES TO SUBMIT BETTER EVIDENCE TO SHOW THAT TRADING OF THE PROPOSED CONTRACT WILL, AS REQUIRED, PROMOTE HEDGING AND OTHER ECONOMIC PURPOSES. CFTC ALSO ANALYZES THE TERMS AND CONDITIONS OF PROPOSED CONTRACTS MORE CLOSELY TO DETECT SUSCEPTIBILITY TO PRICE MANIPULATION OR DISTORTION. HOWEVER, CFTC HAS NOT MATCHED THIS IMPROVEMENT WITH COMPARABLE PROGRESS IN REVIEWING CONTRACTS AFTER APPROVAL TO DETERMINE WHETHER ACTUAL TRADING OF THE CONTRACT SERVES ITS INTENDED PURPOSES. FINALLY, THE COMMISSION HAS YET TO GIVE ADDED FORCE TO THE STATUTORY "PUBLIC INTEREST" TEST FOR CONTRACT APPROVAL, THOUGH IT WENT AS FAR AS PUBLISHING A PROPOSAL TO DO SO IN NOVEMBER 1980.

WE ARE SUGGESTING SPECIFIC CFTC ACTIONS TO ADDRESS EACH OF THESE CONCERNS. IN ADDITION, WE PROPOSE THAT THE COMMISSION INTRODUCE A FEE TO RECOVER THE APPROPRIATE COSTS OF CONTRACT APPROVAL, IN VIEW OF THE SUBSTANTIAL BENEFITS FLOWING TO THE EXCHANGE FROM APPROVAL.

#### MARKET SURVEILLANCE

CFTC'S MARKET SURVEILLANCE PROGRAM SERVES TO DETECT AND ADDRESS ADVERSE SITUATIONS IN FUTURES MARKETS SUCH AS PRICE MANIPULATION. IN CONDUCTING MARKET SURVEILLANCE, THE COMMISSION COLLECTS, ANALYZES, AND COMPARES ON A DAILY BASIS DATA ON THE SUPPLY AND DEMAND CONDITIONS IN THE CASH AND FUTURES MARKETS, AND, IN PARTICULAR, ON THE SIZE AND DOMINANCE OF TRADERS' POSITIONS IN FUTURES MARKETS. BECAUSE OF WEAKNESSES IN ITS OVERALL AUTOMATIC DATA PROCESSING PROGRAM, THE COMMISSION DOES NOT COLLECT AND ANALYZE THIS DATA IN A MANNER WHICH CAN MOST EFFECTIVELY SUPPORT ITS SURVEILLANCE EFFORT. SPECIFIC ACTIONS ARE NEEDED TO IMPROVE THE COMMISSION'S DATA COLLECTION AND PROCESSING SYSTEMS.

COMMODITY EXCHANGES, AS SELF-REGULATORY ORGANIZATIONS, ALSO CONDUCT MARKET SURVEILLANCE. MANY EXCHANGES HAVE INSUFFICIENT DATA TO CARRY OUT SURVEILLANCE, AND THE COMMISSION NEEDS TO INFORM THEM OF THE FULL EXTENT OF THE MARKET PROBLEM BEFORE THEY CAN ACT. WE ARE PROPOSING THAT THE COMMISSION DEVELOP AN APPROACH TO ASSURE THAT THE EXCHANGES HAVE SUFFICIENT DATA. TO FACILITATE THE DEVELOPMENT OF THIS APPROACH, THE CONGRESS SHOULD AMEND SECTION 8a(6) OF THE COMMODITY EXCHANGE ACT TO ALLOW THE COMMISSION TO SHARE ROUTINELY WITH THE EXCHANGES DATA ON TRADERS' POSITIONS.

AUTOMATIC DATA PROCESSING

THE COMMISSION IS EXPERIENCING DIFFICULTIES WITH AUTOMATIC DATA PROCESSING WHICH AFFECT MANY OF ITS PROGRAMS. CFTC CAN IMPROVE ADP SUPPORT BY ESTABLISHING AN INFORMATION RESOURCE PLANNING PROCESS THAT WILL COORDINATE ALL OF CFTC'S INFORMATION REQUIREMENTS AND BY IMPOSING AGENCY-WIDE CONTROLS OVER SOFTWARE DEVELOPMENT.

IN OTHER PROGRAMS AS WELL, OUR REVIEW POINTS OUT NEEDED IMPROVEMENTS. THESE PROGRAMS INCLUDE CFTC'S REPARATIONS PROGRAM, AUDITS AND FINANCIAL SURVEILLANCE, AND REGISTRATION.

THIS CONCLUDES MY STATEMENT. WE WILL BE GLAD TO RESPOND TO YOUR QUESTIONS.